APPRAISAL BULLETIN

PUBLISHED IN THE INTERESTS OF REAL ESTATE ANALYST SUBSCRIBERS BY

ROY WENZLICK & CO.

Real Estate Economists, Appraisers and Counselors

FEBRUARY 27
1947

Volume XVI

Number 5

CONCLUSION OF A SINGLE VALUE

IT has long been our conviction that there can be only a single Value for any particular property at any particular date and that regardless of the method or methods used in reaching an opinion, the appraiser must reach a single conclusion as to its Value. Value is the measure of the utility of a property which does not change in amount because it is measured by different yardsticks.

The two basic estimates of Value have been covered many times in previous bulletins. First, Value is estimated from the physical property by deducting from the reproduction cost of the improvements and the value of the land the depreciation which has accrued during the expended life of the property; and second, the value is found by estimating the present value of the future net income which can be reasonably expected during the remaining economic life of the property. The values determined by these two distinct methods, sometimes referred to as the "physical value" and the "economic value," respectively, represent the appraiser's preliminary estimates which must lead him to a conclusion of a single Value of the property.

The analysis, reconciliation and adjustment necessary for the appraiser to determine a single value often present the most difficult part of the appraisal process, although before the war there were only more or less minor adjustments to be made to bring these two preliminary opinions into agreement. However, since the end of the war when basic real estate markets have been out of balance, it has become a major problem to make the necessary adjustments. Quite recently in making an appraisal of a property for loan purposes, a preliminary figure of $121,375 was estimated for "physical value," and a preliminary figure of $315,000 was estimated for the "economic value." In reconciling and making adjustments in these two values, a final conclusion of a single value of $136,000 was made by both the cost and income approaches.

The data collected by us and furnished us by the owner and the processes followed in reaching the preliminary figures and final Value, are briefly summarized as follows:

<u>Property</u>

Site, 37 feet, 6 inches, x 124 feet, 0 inches, or 4545 sq. ft. Building built in 1911 covers the entire site with two stories and basement of brick with frame interior of average construction quality. It contains 4 stores in basement, 6 stores on 1st floor and 14 offices on 2nd floor. The building contains 163,000 cubic feet and is well maintained and in good repair.

Rents

The property is now 100 per cent occupied. The rents and expenses certified to by owner are as follows:

1st floor and basement.....	$19,080
2nd floor	10,140
Total	$29,220

Expenses

The property is now assessed at $19,930, with taxes at $670. Total expenses given by owner - $4,550, which includes janitor, $600; utilities, $710; heating, $550; maintenance and repair, $1,500; taxes, $670; and insurance, $520.

ESTIMATED VALUES

By comparison, the value of the land was estimated at about $10 per square foot, or $1,250 per front foot of the 37 feet, 6 inches frontage, or a total value of the land of $47,000.

The reproduction cost of the improvements was estimated at 60¢ per cubic foot, plus architect's fees, financing, etc., @ 8.7 per cent or:

163,000 cubic feet @ 60¢	$ 97,750
Fees, 8.7 per cent	8,500
Reproduction cost	$106,250

Preliminary Estimates of Value

Cost Approach

Land, 37.5 feet @ $1,250		$ 47,000
Improvements, Reproduction cost.....	$106,250	
Estimated Depreciation, 30 per cent .	31,875	
Value of Improvements		74,375
Physical Value of Property		$121,375

Income Approach

Gross Income	$29,220	
Vacancies, 10 per cent ..	2,920	
Effective Gross Income		$ 26,300
Expenses, $4,550 + 20 per cent............................		5,460
Net Income		$ 20,840

Using a remaining life of 25 years, a return on the land of 6 per cent and a return on the improvements of 7 per cent, the following value is obtained using the net income of $6,400 applicable to the improvements and the residual amount, or $14,440, to the land:

Net income applicable to land	$14,440
Net income applicable to imp........	6,400
Total Net Income	$20,840

Value of Land, $14,440 divided by .06	$240,625
Value of Improvements, $6,400 x 11.654	74,375
Economic Value of Property.................................	$315,000

We are here confronted with a value from income amounting to 2-1/2 times the value determined from reproduction cost. It will be noticed that the entire difference between them is in the value of the land, which is $240,625 in the former and $47,000 in the latter. If we could correctly assume a value of the land of $240,625, a reconciled value of $315,000 would appear justified.

Upon re-examination we found that a land value of more than $10 per square foot would be unjustified for the long pull. It was also found that commercial rents had risen rapidly during the past year and a half because of a severe shortage of commercial and office space in this outlying section of the metropolitan area. Besides this shortage, there has been, and is today, considerable land speculation caused by several of the larger stores in the downtown section of the metropolitan area purchasing sites for branch stores in this outlying section. Because of this shortage and activity from land speculation, an excessive scarcity premium has been included in the rent for commercial space in this locality, which has doubled in many cases.

There has been great activity in commercial building in this section of the area. It is our belief that present rents are of a temporary nature and that the scarcity premium now paid for rents will disappear. It was necessary to revise our estimate of the future level of rents which can reasonably be expected from the property and it was finally estimated that present rents were 80 per cent above the future level and would probably return in 3-1/2 years, with an estimated average occupancy of 90 per cent. Present construction costs are at an excessive level and will probably decline. The property expenses were revised and taxes were figured on an assessed value of $40,000 instead of $19,930. The total property expense was figured at $6,890 instead of $5,460 used in our preliminary estimates, as shown below.

Finally, the property was appraised by both the cost and income approaches at $136,000, as follows:

Cost Approach

Value of land, 37.5 feet x $1,250		$ 47,000
Reproduction cost of improvements		106,250
Maximum Value		$153,250
Depreciation, 38 per cent	$40,250	
Loss, excessive const. cost, 9.4 per cent	10,000	
Total loss		$ 50,250
Total		$103,000
Gain, favorable rents, 3-1/2 years ($11,000 x 3.0)		33,000
Value of Property		$136,000

Income Approach

Future gross income, $29,220 divided by 180%	$ 16,130
Expected vacancies, 10%	1,620
Future Effective Gross Income	$ 14,510

Property Expenses

Janitor Expense	$ 960	
Utilities	710	
Heating	550	
Management	750	
Maintenance and repair	2,200	
Taxes and insurance	1,720	
Total Expense		$ 6,890
Future Net Income		$ 7,620

Value of land, $2,820 divided by .06	$ 47,000
Value of improvements, $4,800 x 11.654 (25 yrs., 7%)	56,000
Total	$103,000
Excess rent, $11,000 for 3-1/2 yrs. ($11,000 x 3.0)..	33,000
Value of Property	$136,000

It will be noticed that due to the expected decline in rents and costs, the appraised value of the property of $136,000 will decline to $103,000 within 3-1/2 years. It will also be noticed that in estimating by the cost approach, the total loss in value includes 38 per cent as permanent depreciation and 9.4 per cent as a loss from temporary excessive cost of construction.

Of course, the widely differing preliminary opinions are not included as a part of our appraisal report, but only the final conclusion determined by both approaches was included as a part of the appraisal. These notes on an actual appraisal are given to show the special problem and pitfalls which confront the appraiser, especially wherever the markets affecting the property appraised are greatly out of balance.

Similar conditions exist today with apartment properties in most areas having rent ceilings. The unbalanced conditions existing between construction costs and frozen rents make it necessary to reconcile preliminary opinions and to adjust values so that only a single conclusion of value is finally reached.

A. B. Kissack

A. B. KISSACK, M.A.I.